

Message Text

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C O N F I D E N T I A L KINGSTON 4073

E.O. 11652: GDS
TAGS: ECON, EFIN, JM
SUBJECT: COMMENTS ON THE IMF-GOJ PACKAGE: THE ECONOMIC
CONSEQUENCES

REFERENCE: KINGSTON 3945

1. BEGIN SUMMARY: (A) THE GOJ HAD NO REAL ALTERNATIVE TO
GOING THE IMF ROUTE. NEVERTHELESS, IT TOOK COURAGE. THE
HARDER TIMES IN STORE FOR MOST JAMAICANS WILL CREATE SERIOUS
POLITICAL PROBLEMS FOR A REGIME ALREADY UNDER FIRE. PRICES
AND TAXES WILL RISE; MONEY WAGES WILL NOT KEEP PACE,
CAUSING A CONTINUATION OF THE FIVE YEAR DECLINE IN REAL
INCOME AND CONSUMPTION. OUTPUT AND EMPLOYMENT WILL
PROBABLY SUFFER IN THE SHORT RUN DESPITE IMPROVEMENT IN
THE DEVALUATION-STIMULATED EXPORT AND FOREIGN EXCHANGE
SECTORS. THE ECONOMIC BASIS FOR CRIME AND VIOLENCE WILL
DEEPEN.

(B) VIGOROUS POLITICAL AND TECHNICAL LEADERSHIP ARE
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INDISPENSABLE AND THERE IS A QUESTION AS TO WHETHER IT WILL
BE FORTHCOMING. BUT MANLEY HAS COMMITTED HIMSELF TO
TAKE THE PROGRAM TO THE PEOPLE AND HE AND BELL HNVE PUT
THE BUREAUCRACY ON NOTICE. SECURITY FORCES HAVE BEEN
STRENGTHENED BUT WILL HAVE GREATER PROBLEMS COPING IF VIOLENCE
EXCEEDS CURRENT LEVELS.

(C) THE PACKAGE IS TOUGH, EVEN DRASTIC, BUT THE GOJ SEEMS DETERMINED TO CARRY IT OFF. REACTIONS GENERALLY HAVE BEEN ADVERSE, ESPECIALLY AMONG THE LABOR UNIONS, WHICH WILL BE THE MOST DIFFICULT PRESSURE GROUP TO HANDLE. IF THE GOJ PERFORMS WELL, IF THE PRIVATE SECTOR REVIVES AND IF THE NEEDED LEVEL AND TIMELINESS OF EXTERNAL HELP ARRIVE, THEN THE IMF MEDICINE WILL DO ITS JOB. THE BASIS WILL BE LAID FOR FINANCIAL STABILITY, ECONOMIC RECOVERY AND GROWTH. FAILURE COULD LEAD TO RADICAL POLITICAL SOLUTIONS, EITHER OF THE EXTREME LEFT OR RIGHT. END SUMMARY.

2. PRICES, ESPECIALLY OF IMPORTED GOODS, WILL RISE SUBSTANTIALLY DURING THE NEXT SEVERAL MONTHS. SHARP PRICE INCREASES ON GASOLINE, CIGARETTES, BEER, RUM AND UTILITIES HAVE ALREADY BEEN ANNOUNCED. INASMUCH AS SUCH ESSENTIAL COMMODITIES AS WHEAT, CORN, RICE, SALT FISH, CHEESE, MEAT, DRUGS AND PHARMACEUTICALS ARE LARGELY IMPORTED, INCREASES DIRECTLY CAUSED BY THE DEVALUATION WILL HIT HARDEST THOSE WHOSE INCOMES ARE BARELY SUFFICIENT TO COVER MINIMUM BASIC NEEDS.

3. NEITHER SUBSIDIES NOR BULK PURCHASING BY THE STATE TRADING CORPORATION ARE INTENDED TO BE ENOUGH TO FULLY OFFSET THE DEVALUATION, AND REAL CONSUMPTION IS TO BE DEPRESSED. THIS DIRECTION WILL BE RE-INFORCED BY INCREASED CONSUMPTION TAXES. NOR WILL PROBABLE WAGE

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ADJUSTMENTS (WHOSE GUIDELINES PERMIT AN ANNUAL 15 PERCENT INCREASE) PRODUCE AN INCREASE IN MONEY INCOME TO COMPENSATE FOR THE RISE IN PRICES AND TAXES, ESPECIALLY IN THE NON-UNION SECTOR. THIS IS A CARDINAL ELEMENT OF THE PACKAGE'S STRATEGY. IF THE GOVERNMENT CANNOT RESTRAIN MONEY WAGE INCREASES SUFFICIENTLY TO DEPRESS REAL CONSUMPTION, THE ENTIRE PROGRAM IS THREATENED. THE KEY TO WHETHER THIS BASIC PART OF THE PROGRAM WILL BE SUCCESSFULLY CARRIED OFF IS HOW WELL THE GOVERNMENT CAN DEAL WITH THE UNIONS WHICH HAVE ALREADY ASSERTED THEIR OPPOSITION TO WAGE GUIDELINES.

4. IMPORTS WILL BE HELD DOWN THROUGH THE DEVALUATION AND A BROAD ARRAY OF TAX MEASURES. WHILE RESTRAINING IMPORTS, THE GOVERNMENT WILL HAVE TO BE CAREFUL TO ALLOW THOSE IMPORTS ESSENTIAL TO PRODUCTION FOR EXPORTS TO CONTINUE. SOME MODIFICATIONS IN THE GOVERNMENT'S CURRENT PROGRAM WILL BE REQUIRED TO ACHIEVE THIS RESULT. THE NET EFFECT OF THE IMPORT RESTRICTIONS AND THE STIMULUS TO EXPORTS, ESPECIALLY TO BAUXITE, ALUMINA AND TOURISM OVER THE NEXT SEVERAL MONTHS, WILL BE TO IMPROVE FOREIGN EXCHANGE AVAILABILITIES WHICH SHOULD ALLOW THE EXPORT INDUSTRIES

EASIER ACCESS TO HARD CURRENCY FOR NEEDED RAW MATERIALS. THE FOREIGN EXCHANGE SITUATION WILL BE FURTHER AMELIORATED BY IMF AND OTHER DONORS RESOURCES AND BY THE RE-OPENING OF SOME COMMERCIAL CREDIT LINES. THE EXPECTED EXPANSION OF ACTIVITY IN THE EXPORT SECTOR WILL CONTRIBUTE POSITIVELY TO OUTPUT, EMPLOYMENT AND INCOME GROWTH, ALTHOUGH PROBABLY NOT ENOUGH, IN ITSELF, TO OFFSET THE DEPRESSING EFFECTS ON THESE CRITICAL VARIABLES OF THE PROGRAMS'S OVER-ALL RESTRAINTS ON DOMESTIC INCOME AND CONSUMPTION. THUS, DURING THE COMING MONTHS, WE EXPECT SERIOUS PRESSURES ON EMPLOYMENT AND INCOME, WITH POTENTIALLY GRAVE IMPLICATIONS FOR THE GOVERNMENT IN COPING WITH THE ALREADY APPARENT POLITICAL AND SOCIAL RESISTANCE TO ITS PROGRAM.

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5. WHILE THE EXPORT COMPONENT OF THE PRIVATE SECTOR IS LIKELY TO RESPOND FAVORABLY, THE RESTRICTIONS ON DOMESTIC DEMAND WILL ACT AS A DISINCENTIVE TO MUCH OF THE REST OF THE PRIVATE SECTOR. THE GOVERNMENT HOPES THAT THE INCREASED AVAILABILITY OF FOREIGN EXCHANGE AND, THEREFORE, OF NEEDED MATERIALS FOR PRODUCTION, ITS INTENDED GRADUAL LIBERALIZATION OF IMPORT AND EXCHANGE CONTROLS, ITS RECOGNITION OF THE "RIGHT" TO A REASONABLE PROFIT AND OTHER ACTIONS RESPONSIVE TO PRIVATE SECTOR NEEDS WILL ACT, AT LEAST PARTIALLY, TO OFFSET THE DEFLATIONARY EFFECT OF ITS CONSUMPTION-IMPORTS RESTRAINTS. THE PRIVATE SECTOR'S OVER-ALL RESPONSE WILL BE SIGNIFICANTLY INFLUENCED BY HOW DECISIVELY THE GOVERNMENT MOVES TO CARRY OUT ITS INTENTIONS TO ASSIST IT, BY HOW EFFECTIVELY THE GOVERNMENT DEALS WITH THE UNIONS, AND BY NOW SWIFTLY AND TO WHAT EXTENT EXTERNAL PUBLIC AND PRIVATE CAPITAL INFLOWS OCCUR. ON A BROADER LEVEL, THE PRIVATE SECTOR'S PERFORMANCE WILL BE IMPORTANTLY INFLUENCED BY ITS PERCEPTION OF ITS FUTURE IN MANLEY'S "MIXED ECONOMY" OR IN WHATEVER MODEL THE SECTOR BELIEVES IS LIKELY TO EVOLVE.

6. ON THE BASIS OF THE RECORD, THE BUREAUCRACY WOULD BE AN OBSTACLE TO SUCCESSFUL IMPLEMENTATION OF THE PACKAGE. HOWEVER, IT HAS BEEN PUBLICLY CHASTISED BY PRIME MINISTER MANLEY AND FINANCE MINISTER BELL, WHO HAVE CALLED ATTENTION TO THE NEED FOR BETTER PUBLIC SECTOR PERFORMANCE. IF STRONG POLITICAL AND TECHNICAL LEADERSHIP IS PROVIDED AND IF IDEOLOGICAL DIFFERENCES ARE PUT ASIDE, JAMAICA'S PUBLIC SERVICE CAN PROBABLY BE MOBILIZED TO DO ITS NECESSARY PART.
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